

## § 1.661(b)-2

661(a) is deemed to consist of \$5,000 each of taxable interest and royalties, unless the trust instrument specifically provides for the distribution or accumulation of different classes of income or unless local law requires such an allocation. See also § 1.661(c)-1.

### § 1.661(b)-2 Character of amounts distributed when charitable contributions are made.

In the application of the rule stated in § 1.661(b)-1, the items of deduction which enter into the computation of distributable net income are allocated among the items of income which enter into the computation of distributable net income in accordance with the rules set forth in § 1.652(b)-3, except that, in the absence of specific provisions in the governing instrument, or unless local law requires a different apportionment, amounts paid, permanently set aside, or to be used for the charitable, etc., purposes specified in section 642(c) are first ratably apportioned among each class of items of income entering into the computation of the distributable net income of the estate or trust, in accordance with the rules set out in paragraph (b) of § 1.643(a)-5.

### § 1.661(c)-1 Limitation on deduction.

An estate or trust is not allowed a deduction under section 661(a) for any amount which is treated under section 661(b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust. For example, if in 1962, a trust, which reports on the calendar year basis, has distributable net income of \$20,000, which is deemed to consist of \$10,000 of dividends and \$10,000 of tax-exempt interest, and distributes \$10,000 to beneficiary A, the deduction allowable under section 661(a) (computed without regard to section 661(c)) would amount to \$10,000 consisting of \$5,000 of dividends and \$5,000 of tax-exempt interest. The deduction actually allowable under sec-

Rents .....	\$20,000
Dividends .....	10,000
Partially tax-exempt interest .....	10,000
Fully tax-exempt interest .....	\$10,000
Less:	
Expenses allocable thereto (10,000/50,000×\$5,000) .....	\$1,000

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tion 661(a) as limited by section 661(c) is \$4,975, since no deduction is allowable for the \$5,000 of tax-exempt interest and the \$25 deemed distributed out of the \$50 of dividends excluded under section 116, items of distributable net income which are not included in the gross income of the estate or trust.

[T.D. 6777, 29 FR 17809, Dec. 16, 1964]

### § 1.661(c)-2 Illustration of the provisions of section 661.

The provisions of section 661 may be illustrated by the following example:

*Example.* (a) Under the terms of a trust, which reports on the calendar year basis, \$10,000 a year is required to be paid out of income to a designated charity. The balance of the income may, in the trustee's discretion, be accumulated or distributed to beneficiary A. Expenses are allocable against income and the trust instrument requires a reserve for depreciation. During the taxable year 1955 the trustee contributes \$10,000 to charity and in his discretion distributes \$15,000 of income to A. The trust has the following items of income and expense for the taxable year 1955:

Dividends.....	\$10,000
Partially tax-exempt interest .....	10,000
Fully tax-exempt interest .....	10,000
Rents.....	20,000
Rental expenses .....	2,000
Depreciation of rental property.....	3,000
Trustee's commissions.....	5,000

(b) The income of the trust for fiduciary accounting purposes is \$40,000, computed as follows:

Dividends .....	\$10,000
Partially tax-exempt interest .....	10,000
Fully tax-exempt interest .....	10,000
Rents .....	20,000
Total .....	50,000
Less:	
Rental expenses .....	\$2,000
Depreciation .....	3,000
Trustee's commissions .....	5,000
	10,000
Income as computed under section 643(b) .....	40,000

(c) The distributable net income of the trust as computed under section 643(a) is \$30,000, determined as follows:

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Charitable contributions allocable thereto (10,000/50,000×\$10,000) .....	2,000	
		3,000
		7,000
Total .....		47,000
Deductions:		
Rental expenses .....	2,000	
Depreciation of rental property .....	3,000	
Trustee's commissions (\$5,000 less \$1,000 allocated to tax-exempt interest) .....	4,000	
Charitable contributions (\$10,000 less \$2,000 allocated to tax-exempt interest) ..	8,000	
		17,000
Distributable net income (section 643(a)) .....		30,000

(d) The character of the amounts distributed under section 661(a), determined in accordance with the rules prescribed in §§ 1.661(b)-1 and 1.661(b)-2 is shown by the following table (for the purpose of this allocation, it is assumed that the trustee elected to allocate the trustee's commissions to rental income except for the amount required to be allocated to tax-exempt interest):

	Rental income	Taxable dividends	Excluded dividends	Partially tax-exempt interest	Tax-exempt interest	Total
Trust income ....	\$20,000	\$9,950	\$50	\$10,000	\$10,000	\$50,000
Less:						
Charitable contributions .....	4,000	2,000	.....	2,000	2,000	10,000
Rental expenses .....	2,000	.....	.....	.....	.....	2,000
Depreciation ..	3,000	.....	.....	.....	.....	3,000
Trustee's commissions .....	4,000	.....	.....	.....	1,000	5,000
Total deductions	13,000	2,000	0	2,000	3,000	20,000
Distributable net income .....	7,000	7,950	50	8,000	7,000	30,000
Amounts deemed distributed under section 661(a) before applying the limitation of section 661(c) .....	3,500	3,975	25	4,000	3,500	15,000

In the absence of specific provisions in the trust instrument for the allocation of different classes of income, the charitable contribution is deemed to consist of a pro rata portion of the gross amount of each item of income of the trust (except dividends excluded under section 116) and the trust is deemed to have distributed to A a pro rata portion (one-half) of each item of income included in distributable net income.

(e) The taxable income of the trust is \$11,375 computed as follows:

Rental income .....	\$20,000	
Dividends (\$10,000 less \$50 exclusion) .....		9,950
Partially tax-exempt interest .....		10,000
Gross income .....		39,950
Deductions:		
Rental expenses .....	\$2,000	
Depreciation of rental property ...	3,000	
Trustee's commissions .....	4,000	
Charitable contributions .....	8,000	
Distributions to A .....	11,475	
Personal exemption .....	100	
		28,575
Taxable income .....		11,375